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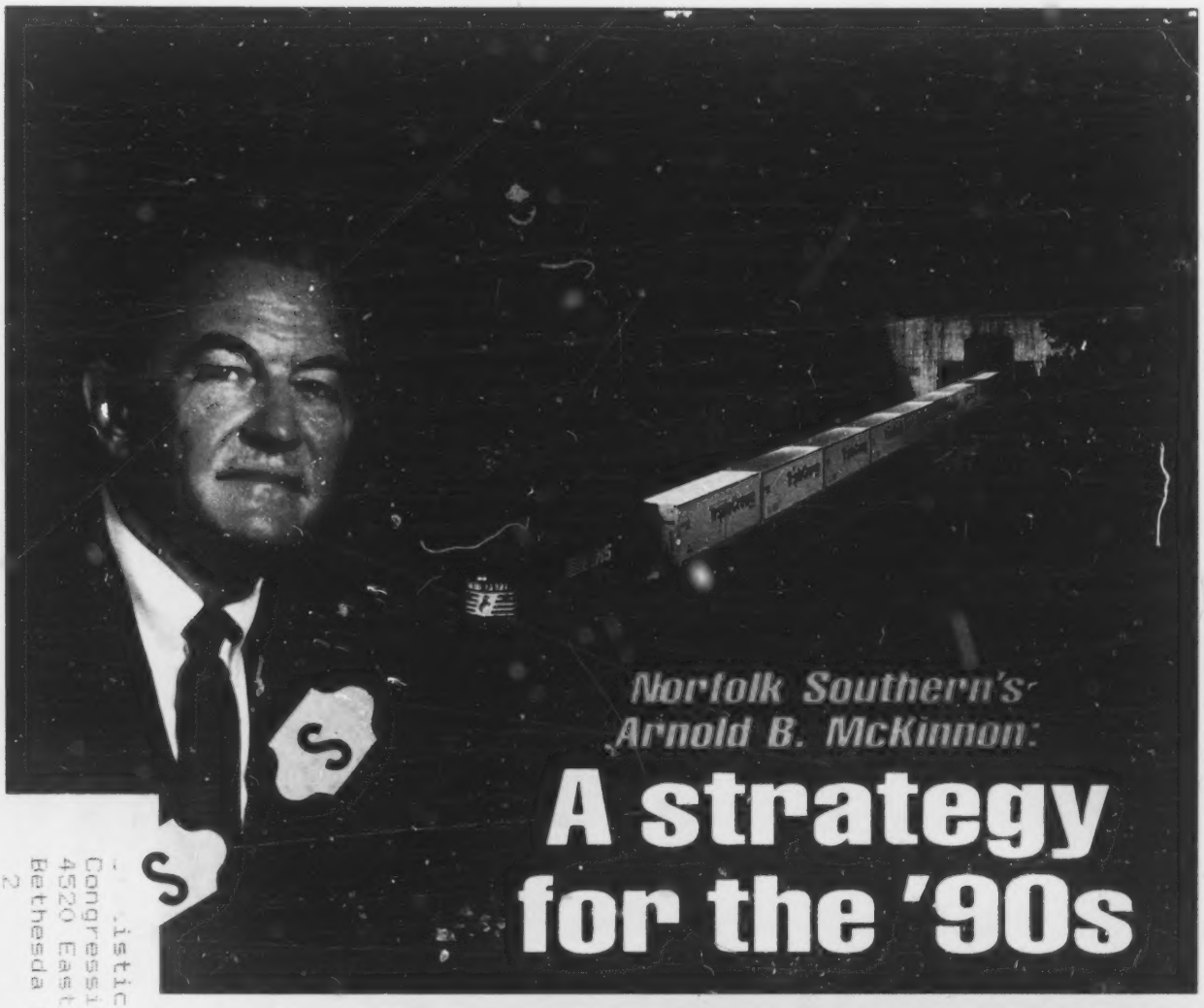
Railway Age

...for the new age of railways and rail transit



Norfolk Southern's Arnold B. McKinnon:

A strategy for the '90s

The story behind the switch to a.c.

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INSIDE

Norfolk Southern: Tracking a winner

LUTHER S. MILLER

For most railroads, the decade of the '80s has been a time of renaissance and recovery. Consistently among the best performers, and often at the top of the list in operating efficiency and profits, has been the Norfolk Southern. How did NS get to the pinnacle, and how does NS propose to stay there? What are some of the challenges the railroad industry must come to grips with in the coming decade? We recently put these questions to Norfolk Southern's chairman, president, and CEO, Arnold B. McKinnon, in a wide-ranging interview conducted in NS's new headquarters building in Norfolk, Va. Much of what Mr. McKinnon told us added up to "A strategy for the '90s," and that's the title under which the transcript of our exchange appears, beginning on p. 33.

Track maintenance is a major theme of this issue, which will have additional distribution at the meetings in Toronto later this month of the American Bridge & Building Association and the Roadmasters and Maintenance of Way Association of America, with concurrent exhibits staged by the Railway Engineering-Maintenance Suppliers Association (REMSA). We surveyed major railroad systems in the U.S. and Canada for Senior Editor Gus Welty's report, "M/w equipment: What chief engineers want" (p. 43). What the equipment suppliers are offering is the subject of the story that follows (p. 47).

Norfolk Southern's CEO himself had some trenchant comments on the art and science of track maintenance, and not surprisingly: NS's Southern Railway virtually invented the modern-day track machine, which revolutionized maintenance practices and drastically reduced m/w manpower needs.

Mr. McKinnon observed that his railroad this year will spend about 34% of a nearly $700 million capital budget on track replacement, and another 18% on "non-discretionary safety and environmental projects" which often come under the T&S department. He expects this level of investment to continue for the foreseeable future, whatever blips appear on the traffic charts.

"We try to maintain our core system to a steady level which will let us provide superior service and safe operation," he told us. "Peak-and-valley maintenance is expensive. You get more bang for your buck if you maintain a steady level of roadway maintenance."

While NS is generous with its track dollars, it also demands more productivity from them.

One way of achieving this, said Mr. McKinnon, "is to develop better methods of using system gangs with mechanized equipment. We've gone from 22 T&S gangs in 1982 to 13 in 1989, and we're working the same number of track miles. Another way is adding to the equipment—a piece here, a piece there." Right now, he said, NS is looking for an economical field weld that's just as good as a plant weld.

For railroads that want to add a piece here, a piece there, the REMSA show in Toronto Aug. 27-30 will be a good place to start. There'll be a great array of machines on view—including some capable of producing quality field welds, economically.

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MARKET OUTLOOK

Equipment

Miner Railcar Services: Is offering for sale 55 reconditioned, 70-ton, four-outlet ballast cars with 2,000 cubic foot capacity and a light weight of 50,000 pounds.

New Jersey Transit: Ordered 50 new commuter cars from Bombardier at a cost of approximately $41.5 million, with options for 75 additional coaches that would bring the total value of the order to around $100 million. Delivery is to begin 12½ months after signing of the contract, which was announced July 25; an incentive clause would boost payments by $3.8 million for accelerated delivery.

Sacramento Regional Transit District: Placed a $14 million order with Siemens-Duewag for 10 additional 64-passenger, U2 model light rail vehicles. Siemens Energy & Automation, Inc., of Atlanta is the prime contractor. Siemens will supply the electrical equipment and Duewag will construct the cars. The order will bring Sacramento's fleet to 36 cars.

Southern Pacific: Placed an order with the Locomotive Group of General Motors for 50 four-axle, 3,800-hp, GP60 diesel-electric units at a total cost of more than $50 million. Delivery is scheduled for first quarter 1990.

- Placed a $15 million order with Gunderson for 325 100-ton, 3,200-cubic-foot capacity gondola cars for the transport of steel and steel products. Deliveries begin this month.

Facilities

City of Chicago: Awarded a $19.3 million contract to Union Switch & Signal for a complete train control system for the new 10-mile double-track line Chicago Transit Authority is building between downtown Chicago and Midway Airport. The line encompasses 14 interlockings. The project involves application of US&S's Microlok (vital) and Gensys (non-vital) microprocessor-based interlocking control equipment, as well as switch machines, signals, audio frequency track circuits, and train stops.

CSX Transportation: Is completing the installation of eight sets of No. 16 turnouts, each set consisting of 101 concrete ties supplied by Abetong-America, fastening systems supplied by Pandrol, and steel parts from Cogifer.

Revenue freight carloadings

Commodity	July 15 week	July 8 week	July 1 week	June 24 week	June 17 week
Grain	27,503	21,153	28,929	27,654	25,430
Other farm products	1,538	1,143	1,617	2,017	2,095
Metallic ores	26,309	22,016	25,673	23,222	22,590
Coal	91,365	75,022	95,197	113,070	121,990
Crushed stone, gravel and sand	17,742	12,494	17,104	17,128	16,586
Nonmetallic minerals	10,352	8,417	10,306	[illegible]36	10,192
Grain mill products	9,795	8,540	10,154	9,880	9,877
Food and kindred products	8,598	7,140	8,555	8,379	8,636
Primary forest products	9,645	5,892	9,541	9,251	9,124
Lumber and wood products	8,421	4,385	7,598	7,337	6,836
Pulp, paper and allied products	10,551	10,358	10,391	10,463	10,568
Chemicals and allied products	25,098	24,267	25,593	24,978	25,701
Petroleum products	5,486	4,454	5,484	4,991	4,962
Stone, clay and glass products	11,084	8,729	10,657	10,195	10,436
Coke	5,050	4,949	5,408	5,244	5,455
Metals and products	8,700	7,315	10,465	9,812	9,256
Motor vehicles and equipment	10,254	9,644	17,400	19,626	20,558
Waste and scrap materials	8,159	5,585	8,551	8,482	9,126
All other carloads	6,945	4,801	7,647	6,999	7,026
Total Cars Loaded	301,095	246,303	316,948	320,306	326,461
% change from previous year	(9.6)	(9.9)	(3.0)	(5.7)	(3.2)

		% change
Cumulative total: 28 weeks	9,277,480	(.6)

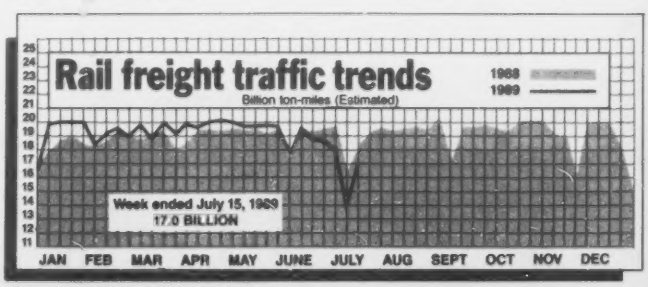
Intermodal revenue ton-miles (billions)	17.0	13.9	18.0	18.6	18.9
% change from previous year	(11.0)	(10.3)	(1.0)	(4.0)	(3.0)

Total:	1989	1988	% change
28 weeks	531.0	531.9	.0

Intermodal traffic

	July 15	July 8	July 1	June 24	June 17
Trailers	62,129	49,187	66,890	65,363	65,214
Containers	47,495	38,646	46,064	46,240	44,991
Total	109,624	87,833	112,954	111,603	110,205
% change from previous year	(1.1)	(12.9)	(5.2)	(3.2)	(2.8)

		% change
Cumulative total: 28 weeks	3,098,107	.0


Rail freight traffic trends
Billion ton-miles (Estimated)
1988
1989
Week ended July 15, 1989
17.0 BILLION
JAN FEB MAR APR MAY JUNE JULY AUG SEPT OCT NOV DEC

Source: Association of American Railroads

Freight cars

	DELIVERED 2nd quarter 1989	DELIVERED 2nd quarter 1988	ORDERED 2nd quarter 1989	ORDERED 2nd quarter 1988	ON ORDER AND UNDELIVERED July 1 1989	ON ORDER AND UNDELIVERED July 1 1988
Built new by carbuilders	7,838	4,599	5,649	9,131	16,398*	17,225
Built new in RR shops	0	0	0	0	0	0
Built new—Total	7,838	4,599	5,649	9,131	16,398	17,225
Rebuilt	0	70	0	0	0	211
TOTAL	7,838	4,669	5,649	9,131	16,398	17,436
Locomotives (new and rebuilt)	288	408	N/A	N/A	146	126

*Adjusted for 1st quarter.

Source: Transportation Div., AAR and American Railway Car Institute

Profits drop as costs rise faster than revenues

Class I railroads posted a 1% increase in traffic volume in this year's first quarter, but per-ton-mile revenue climbed by only 0.5%. Meanwhile, operating expenses rose by 3.5%, and the net result was a 20% decline in railway operating income, from $556 million in first quarter '88 to $443 million this year.

William H. Dempsey, president of the Association of American Railroads, observed that "while railroads had regulatory freedom, under the Rail Cost Adjustment Factor, to increase rates by 3.8% during the first quarter of 1988, competition held those increases to 0.5%. The relatively small 0.5% actual gain in freight revenue per ton-mile is a reflection of the competitiveness of the transportation marketplace."

Ordinary income, which includes earnings from outside sources, was down 1.9% in the first quarter, from $517.4 million to $507.5 million.

CLASS I RAILROADS IN THE UNITED STATES

	First Quarter 1989 (millions)	1988 (millions)
Operating Revenues	$6,995.9	$6,878.9
Operating Expenses	6,266.1	6,051.2
Net Revenue from Operations		
United States	730.8	827.7
Eastern District	424.9	382.2
Western District	305.9	445.5
Ordinary Income		
United States	507.5	517.4
Eastern District	308.7	215.9
Western District	198.8	301.5
Net Railway Operating Income		
United States	442.7	555.7
Eastern District	257.6	249.5
Western District	185.1	306.1
Rate of Return on Net Investment*	5.15%	5.34%

*Defined as reported net railway operating income divided by average net property investment reduced by accumulated deferred tax credits.

For SP, Rio Grande: "Chicago at last"

Interstate Commerce Commission approval will be required, but the deal is done for Rio Grande Industries to buy 532 miles of railroad from Soo Line Corp., a line east from Kansas City that will give the RGI rail system entry to Chicago. Purchase price is $86 million, and it may be a bargain, considering that the RGI railroads are the only major western rail system without access to the Chicago gateway.

Said Mike Mohan, president of RGI's Southern Pacific and Rio Grande railroads: "We will reach Chicago at last. [That] has been a goal of our railroads for over a century. This will add new competitive force to our services, not just in the important Chicago market but, through Chicago, all across the nation."

Under the agreement, Soo Line would have trackage rights in order to serve all points on the Kansas City-Chicago line for traffic moving to or from its own rail system. The RGI railroads would get direct access to customers in Milwaukee and Dubuque, Iowa, through a haulage agreement with Soo Line, and Soo's Chicago yards would handle SP-Rio Grande trains.

Edwin V. Dodge, president and chief executive officer of Soo, said that the planned arrangement "recognizes the distinct marketing needs of each carrier. As the new owner, Southern Pacific will achieve its major objective to reach Chicago, while Soo will be able to offer its customers continued access to important markets on the line."

Santa Fe was the first of the so-called transcontinentals to run Chicago-West Coast on its own rails. Burlington Northern got access through merger of Great Northern, Northern Pacific and Chicago, Burlington & Quincy almost 20 years ago. Union Pacific got it more recently, through merger with Missouri Pacific, and UP also has a close working relationship with Chicago & North Western.

RGI is hoping for fast action on its application to the ICC. Said Mike Mohan: "This is a simple transaction that will enhance competition in the transportation marketplace. We believe there is good reason for the ICC to consider it on an expedited time schedule."

CR program guards shareholder rights

Conrail last month announced the establishment of a shareholder rights program—a dividend distribution of one common share purchase right for each outstanding share of Conrail common stock.

Conrail Chairman, President and CEO James A. Hagen said the plan is "designed to assure that all of Conrail's stockholders receive fair and equal treatment in the event of any proposed takeover of the company and to guard against the use of abusive tactics to gain control of the company without paying all shareholders a premium. [It] will not prevent a takeover of the company, but should encourage anyone seeking to acquire the company to negotiate with the board of directors prior to attempting a takeover." He added that the plan "is not being implemented in response to any particular takeover threat or proposal."

At the same time Conrail announced a dividend of 35 cents a share payable Sept. 15, a 17% increase over the 30 cents dividend paid June 15.

Conrail reported second quarter 1989 net income of $82 million, compared with $97 million in the corresponding 1988 period. First half 1989 income was $142 million, down from $145 million in 1988.

Hagen said that in view of lower than expected traffic and revenue levels, the railroad had implemented "a more aggressive cost control program" to achieve its 1989 income goals.